COSTCO WHOLESALE CORP /NEW
Form 10-K
October 18, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended August 29, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.005 Par Value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ¨ NO x

The aggregate market value of the voting stock held by non-affiliates of the registrant at February 14, 2010 was $25,866,245,752

The number of shares outstanding of the registrant s common stock as of October 1, 2010 was 432,333,947

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement for the Annual Meeting of Stockholders to be held on January 27, 2011, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED AUGUST 29, 2010

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Certain statements contained in this document constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements. See Item 1A Risk Factors for a discussion of risks and uncertainties that may affect our business.

PART I

Item 1 Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983 in Seattle, Washington. In October 1993, we merged with The Price Company, which had pioneered the membership warehouse concept, to form Price/Costco, Inc., a Delaware corporation. In January 1997, after the spin-off of most of our non-warehouse assets to Price Enterprises, Inc., we changed our name to Costco Companies, Inc. On August 30, 1999, we reincorporated from Delaware to Washington and changed our name to Costco Wholesale Corporation. Our common stock trades on The NASDAQ Global Select Market under the symbol COST.

General

We operate membership warehouses based on the concept that offering our members low prices on a limited selection of nationally branded and selected private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. This turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables us to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters.

We buy the majority of our merchandise directly from manufacturers and route it to a cross-docking consolidation point (depot) or directly to our warehouses. Our depots receive container-based shipments from manufacturers and reallocate these goods for shipment to our individual warehouses, generally in less than twenty-four hours. This maximizes freight volume and handling efficiencies, eliminating many of the costs associated with traditional multiple-step distribution channels. Such traditional steps include purchasing from distributors as opposed to manufacturers, use of central receiving, storing and distributing warehouses, and storage of merchandise in locations off the sales floor.

Because of our high sales volume and rapid inventory turnover, we generally sell inventory before we are required to pay many of our merchandise vendors, even though we take advantage of early payment discounts when available. To the extent that sales increase and inventory turnover becomes more rapid, a greater percentage of inventory is financed through payment terms provided by suppliers rather than by our working capital.

Our typical warehouse format averages approximately 143,000 square feet; newer units tend to be larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and the availability of low prices, our warehouses need not have elaborate facilities. By strictly controlling the entrances and exits of our warehouses and using a membership format, we have limited inventory losses (shrinkage) to less than two-tenths of one percent of net sales in the last several fiscal years well below those of typical discount retail operations.

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Item 1 Business (Continued)

We generally limit marketing and promotional activities to new warehouse openings, occasional direct mail to prospective new members, and regular direct marketing programs (such as The Costco Connection, a magazine we publish for our members, coupon mailers, weekly email blasts from costco.com, and handouts) to existing members promoting selected merchandise. These practices result in lower marketing expenses as compared to typical retailers. In connection with new warehouse openings, our marketing teams personally contact businesses in the area that are potential business members. These contacts are supported by direct mailings during the period immediately prior to opening. Potential Gold Star (individual) members are contacted by direct mail or by membership offerings distributed through employee associations and other entities. After a membership base is established in an area, most new memberships result from word-of-mouth advertising, follow-up messages distributed through employee groups, and ongoing direct solicitations to prospective members.

Our warehouses generally operate on a seven-day, 69-hour week, open weekdays between 10:00 a.m. and 8:30 p.m., with earlier closing hours on the weekend. Gasoline operations generally have extended hours. Because the hours of operation are shorter than those of traditional retailers, discount retailers and supermarkets, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities, thereby reducing labor required for handling and stocking.

Our strategy is to provide our members with a broad range of high quality merchandise at prices consistently lower than they can obtain elsewhere. We seek to limit specific items in each product line to fast-selling models, sizes and colors. Therefore, we carry an average of approximately 3,900 active stock keeping units (SKUs) per warehouse in our core warehouse business, as opposed to 45,000 to 140,000 SKUs or more at discount retailers, supermarkets, and supercenters. Many consumable products are offered for sale only in case, carton, or multiple-pack quantities only.

In keeping with our policy of member satisfaction, we generally accept returns of merchandise. On certain electronic items, we have a 90-day return policy in the United States, Canada and the United Kingdom and provide, free of charge, technical support services, as well as an extended warranty.

The following table indicates the approximate percentage of net sales accounted for by major category of items:

	2010	2009	2008
Sundries (including candy, snack foods, tobacco, alcoholic and nonalcoholic beverages and cleaning and institutional supplies)	23%	23%	22%
Hardlines (including major appliances, electronics, health and beauty aids, hardware, office supplies, garden and patio, sporting goods, toys, seasonal items and automotive supplies)	18%	19%	19%
Food (including dry and institutionally packaged foods)	21%	21%	20%
Softlines (including apparel, domestics, jewelry, housewares, media, home furnishings, cameras and small appliances)	10%	10%	10%
Fresh Food (including meat, bakery, deli and produce)	12%	12%	12%
Ancillary and Other (including gas stations, pharmacy, food court, optical, one-hour photo, hearing aid and travel)	16%	15%	17%

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Item 1 Business (Continued)

Ancillary businesses within or next to our warehouses provide expanded products and services and encourage members to shop more frequently. The following table indicates the number of ancillary businesses in operation at fiscal year end:

	2010	2009	2008
Food Court	534	521	506
One-Hour Photo Centers	530	518	504
Optical Dispensing Centers	523	509	496
Pharmacies	480	464	451
Gas Stations	343	323	307
Hearing-Aid Centers	357	303	274
Print Shops and Copy Centers	10	10	7
Car Washes	7	2	2
Number of warehouses	540	527	512

Costco Mexico, our 50%-owned joint venture, operated 32 warehouses at August 29, 2010. We have contractual responsibility for executive, management and functional duties and operations of Costco Mexico. The Costco Mexico warehouses are not included in the table above as Costco Mexico is accounted for using the equity method of accounting for investments.

Our electronic commerce businesses, costco.com in the U.S. and costco.ca in Canada, provide our members additional products generally not found in our warehouses, in addition to services such as digital photo processing, pharmacy, travel, and membership services.

Our warehouses accept cash, checks, certain debit cards, American Express and a private label Costco credit card. Losses associated with dishonored checks have been minimal, as members who have issued dishonored checks are identified and prevented from making further purchases until restitution is made.

We have direct buying relationships with many producers of national brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. We have not experienced any difficulty in obtaining sufficient quantities of merchandise, and believe that if one or more of our current sources of supply became unavailable, we would be able to obtain alternative sources without substantial disruption of our business. We also purchase selected private label merchandise, as long as quality and customer demand are comparable and the value to our members is greater as compared to name brand items.

Certain financial information for our segments and geographic areas is included in Note 12 to the accompanying consolidated financial statements included in Item 8 of this Report.

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is an increased level of net sales and earnings during the winter holiday season. References to 2010, 2009, and 2008 relate to the 52-week fiscal years ended August 29, 2010, August 30, 2009, and August 31, 2008, respectively.

Membership Policy

Our membership format is designed to reinforce customer loyalty and provide a continuing source of membership fee revenue. Members can utilize their memberships at any Costco warehouse location in

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Item 1 Business (Continued)

any country. We have two primary types of members: Business and Gold Star (individual). Our member renewal rate, currently at 88% in the U.S. and Canada, is consistent with recent years. Businesses, including individuals with a business license, retail sales license or other evidence of business existence, may become Business members. Business members generally pay an annual membership fee of $50 for the primary and household membership card, with add-on membership cards available for an annual fee of $40 (including a free household card). Many of our business members also shop at Costco for their personal needs. Individual memberships (Gold Star memberships) are available to individuals who do not qualify for a Business membership, for an annual fee of $50, which includes a household card.

Our membership base was made up of the following (in thousands):

	2010	2009	2008
Gold Star	22,500	21,500	20,200
Business	5,800	5,700	5,600
Business, Add-on Primary	3,300	3,400	3,400
Total primary cardholders	31,600	30,600	29,200
Additional cardholders	26,400	25,400	24,300
Total cardholders	58,000	56,000	53,500

These numbers exclude approximately 2,900 cardholders of Costco Mexico at the end of 2010, and 2,800 cardholders at the end of 2009 and 2008.

Executive membership is available to all members, with the exception of Business Add-on members, in the U.S., Canada, Mexico, and the United Kingdom for an annual fee of approximately $100. The program, in the U.S. and Canada, offers additional savings and benefits on various business and consumer services, such as merchant credit-card processing, auto and home insurance, the Costco auto purchase program, and check printing services. The services are generally provided by third-parties and vary by country and state. In addition, Executive members qualify for a 2% annual reward (which can be redeemed at Costco warehouses), up to a maximum of approximately $500 per year, on qualified purchases made at Costco. At the end of 2010, 2009, and 2008, Executive members represented 36%, 33%, and 30%, respectively, of our primary membership base that was eligible for the program. Executive members generally spend more than other members, and the percentage of our net sales attributable to these members continues to increase.

Labor

Our employee count approximated:

	2010	2009	2008
Full-time employees	82,000	79,000	75,000
Part-time employees	65,000	63,000	62,000
Total employees	147,000	142,000	137,000

These numbers exclude approximately 9,000 individuals who were employed by Costco Mexico at the end of 2010, 2009, and 2008. Approximately 13,200 hourly employees in certain of our locations (all former Price Company locations) in five states are represented by the International Brotherhood of Teamsters. All remaining employees are non-union. We consider our employee relations to be very good.

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Item 1 Business (Continued)

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, warehouse location and member service. We compete with 800 warehouse club locations across the U.S. and Canada (Wal-Mart s Sam s Club and BJ s Wholesale Club), and every major metropolitan area has multiple club operations. In addition, we compete with a wide range of national and regional retailers and wholesalers, including supermarkets, supercenters, general merchandise chains, specialty chains, and gasoline stations, as well as electronic commerce businesses. Competitors such as Wal-Mart, Target, Kohl s and Amazon are among our significant general merchandise retail competitors. We also compete with low-cost operators selling a single category or narrow range of merchandise, such as Lowe s, Home Depot, Office Depot, PetSmart, Staples, Trader Joe s, Whole Foods, Best Buy and Barnes & Noble. Our international operations face similar competitors.

Regulation

Certain state laws require that we apply minimum markups to our selling prices for specific goods, such as tobacco products, alcoholic beverages, and gasoline. While compliance with such laws may cause us to charge higher prices, other retailers are also typically governed by the same restrictions, and we believe that compliance with such laws currently in effect do not have a material adverse effect on our operations.

Certain states, counties, and municipalities have enacted or proposed laws and regulations that would prevent or restrict the operations or expansion plans of certain large retailers and warehouse clubs, including us, within their jurisdictions. If enacted, such laws and regulations could have a material adverse affect on our operations.

Intellectual Property

We believe that our trademarks, trade names, copyrights, proprietary processes, trade secrets, patents, trade dress and similar intellectual property add significant value to our business and are important factors in our success. We have invested significantly in the development and protection of our well-recognized brands, including the Costco Wholesale® series of trademarks and our private label brand, Kirkland Signature®. Kirkland Signature products are premium products offered to our members at prices that are generally lower than those for national brand products. Kirkland Signature products allow us to ensure our quality standards are met, while minimizing costs and differentiating our merchandise offerings from other retailers, and to generally earn higher margins. We expect that our private label items will increase their share of our sales in the future. We rely on trademark and copyright law, trade secret protection, and confidentiality and license agreements with our employees and others to protect our proprietary rights. Effective intellectual property protection may not be available in every country in which we operate.

Available Information

Our internet website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with, or furnishing such documents to, the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC.

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Item 1 Business (Continued)

Executive Officers of the Registrant

The following is a list of the names, ages, and positions of the executive officers of the Company. All executive officers have 25 or more years of service with the Company.

Name	Position With Company	Executive Officer Since	Age
James D. Sinegal	Chief Executive Officer. Mr. Sinegal is a co-founder of the Company and has been a director since its inception. In February 2010, Mr. Sinegal relinquished his role as President of the Company, which he had held since the Company s inception.	1983	74
Jeffrey H. Brotman	Chairman of the Board. Mr. Brotman is a co-founder of the Company and has been a director since its inception.	1983	68
W. Craig Jelinek	President and Chief Operating Officer. Mr. Jelinek has been President and Chief Operating Officer of the Company since February 2010, when he also joined the Board of Directors. Prior to that date, he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	58
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director of the Company since January 1995.	1993	54
Paul G. Moulton	Executive Vice President and Chief Information Officer. He was Executive Vice President, Real Estate Development until March 2010.	2001	59
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions.	1994	58
Douglas W. Schutt	Executive Vice President, Chief Operating Officer, Merchandising. He was Executive Vice President, Chief Operating Officer, Northern and Midwest Division from 2004 to March 2010.	2004	51
John D. McKay	Executive Vice President, Chief Operating Officer, Northern and Midwest Division. He was Senior Vice President, General Manager, Northwest Region from 2000 to March 2010.	2010	53
Thomas K. Walker	Executive Vice President, Construction, Distribution and Traffic.	2004	70
Dennis R. Zook	Executive Vice President, Chief Operating Officer, Southwest and Mexico Divisions.	1993	61

The Company has adopted a code of ethics for senior financial officers pursuant to section 406 of the Sarbanes-Oxley Act. Copies of the code are available free of charge by writing to Secretary, Costco Wholesale Corporation, 999 Lake Drive, Issaquah, WA 98027.

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Item 1A Risk Factors

The risks described below could materially and adversely affect our business, financial condition, and results of operations. These risks could cause our actual results to differ materially from our historical experience and from results or events predicted by our forward-looking statements. Those statements may relate to such matters as sales growth, increases in comparable store sales, cannibalization of existing locations by new openings, price changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense control, membership renewal rates, shopping frequency, litigation impact and the demand for our products and services. You should read these risk factors in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Report and our consolidated financial statements and related notes in Item 8 of this Report. There may be other factors that we cannot anticipate or that are not described in this report, generally because we do not presently perceive them to be material, that could cause results to differ materially from our expectations or statements. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these forward-looking statements. You are advised to review any further disclosures we make on related subjects in our periodic filings with the SEC.

We face strong competition from other retailers and warehouse club operators, which could negatively affect our financial performance.

The retail business is highly competitive. We compete for members, employees, sites, products and services and in other important respects with many other local, regional and national retailers, both in the United States and in foreign countries. We compete with other warehouse club operators, discount retailers, supermarkets, supercenter stores, retail and wholesale grocers, department, drug, variety and specialty stores and general merchandise wholesalers and distributors, as well as internet-based retailers, wholesalers and catalog businesses. Such retailers and warehouse club operators compete in a variety of ways, including merchandise pricing, selection and availability, services, location, convenience, store hours, and price. Our inability to respond effectively to competitive pressures and changes in the retail markets could negatively affect our financial performance. Some competitors may have greater financial resources, better access to merchandise, and greater market penetration than we do.

General economic factors, domestically and internationally, may adversely affect our financial performance.

Higher interest rates, energy costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes related to government fiscal and tax policies and other economic factors could adversely affect demand for our products and services or require a change in the mix of products we sell. Prices of certain commodity products, including gasoline and other food products, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations and periodic delays in delivery. Rapid and significant changes in commodity prices may affect our sales and profit margins. These factors can also increase our merchandise costs and/or selling, general and administrative expenses, and otherwise adversely affect our operations and results. General economic conditions can also be affected by the outbreak of war, acts of terrorism, or other significant national or international events.

Item 1A Risk Factors (Continued)

Our growth strategy includes expanding our business, both in existing markets and in new markets.

Our future growth is dependent, in part, on our ability to acquire property, and build or lease new warehouses. We compete with other retailers and businesses for suitable locations. Local land use and other regulations restricting the construction and operation of our warehouses, as well as local community actions opposed to the location of our warehouses at specific sites and the adoption of local laws restricting our operations and environmental regulations may impact our ability to find suitable locations, and increase the cost of constructing, leasing and operating our warehouses. We also may have difficulty negotiating leases or real estate purchase agreements on acceptable terms. Failure to manage these and other similar factors effectively will affect our ability to timely build or lease new warehouses, which may have a material adverse affect on our future growth and profitability.

We seek to expand our business in existing markets in order to attain a greater overall market share. Because our warehouses typically draw members from their local areas, a new warehouse may draw members away from our existing warehouses and adversely affect comparable warehouse sales performance and member traffic at those existing warehouses.

We also intend to open warehouses in new markets. The risks associated with entering a new market include difficulties in attracting members due to a lack of familiarity with us, attracting members of other wholesale club operators currently operating in the new market, our lack of familiarity with local member preferences, and seasonal differences in the market. In addition, entry into new markets may bring us into competition with new competitors or with existing competitors with a large, established market presence. In new markets, we cannot ensure that our new warehouses will be profitably deployed; as a result, our future profitability may be delayed or otherwise materially adversely affected.

We are highly dependent on the financial performance of our United States and Canada operations.

Our financial and operational performance is highly dependent on our United States and Canada operations, which comprised 92% of consolidated net sales in 2010 and 93% in 2009, and 89% of operating income in 2010 and 92% in 2009. Within the United States, we are highly dependent on our California operations, which comprised 26% and 27% of consolidated net sales in 2010 and 2009, respectively. Our California market in general, has a larger percentage of higher volume warehouses as compared to our other markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our United States operations, particularly in California, and our Canada operations could arise from, among other things: failing to meet targets for warehouse openings; declines in actual or estimated comparable warehouse sales growth rates and expectations; negative trends in operating expenses, including increased labor, healthcare and energy costs; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets; and failing consistently to provide high quality products and innovative new products to retain our existing member base and attract new members.

We depend on vendors to supply us with quality merchandise at the right prices in a timely manner.

We depend heavily on our ability to purchase merchandise in sufficient quantities at competitive prices. We have no assurances of continued supply, pricing or access to new products, and any vendor could at any time change the terms upon which it sells to us or discontinue selling to us. Member demands may lead to out-of-stock positions of our merchandise, leading to loss of sales and profits.

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Item 1A Risk Factors (Continued)

We purchase our merchandise from numerous domestic and foreign manufacturers and importers and have thousands of vendor relationships. Our inability to acquire suitable merchandise on acceptable terms or the loss of key vendors could negatively affect us. We may not be able to develop relationships with new vendors, and products from alternative sources, if any, may be of a lesser quality or more expensive than those from existing vendors. Because of our efforts to adhere to high quality standards for which available supply may be limited, particularly for certain food items, the large volume we demand may not be consistently available.

Our suppliers are subject to risks, including labor disputes, union organizing activities, financial liquidity, inclement weather, natural disasters, supply constraints, and general economic and political conditions, that could limit their ability to timely provide us with acceptable merchandise. For these or other reasons, one or more of our suppliers might not adhere to our quality control, legal or regulatory standards. These deficiencies may delay or preclude delivery of merchandise to us and might not be identified before we sell such merchandise to our members. This failure could lead to litigation and recalls, which could damage our reputation and our brands, increase our costs, and otherwise hurt our business.

In addition, the United States foreign trade policies, tariffs and other impositions on imported goods, security and safety regulations, trade sanctions imposed on certain countries, the limitation on the importation of certain types of goods or of goods containing certain materials from other countries and other factors relating to foreign trade are beyond our control and could adversely impact our sourcing of goods.

We depend on our depot operations to effectively and efficiently supply product to our warehouses.

We depend on the orderly operation of the receiving and distribution process, primarily through our depots. Although we believe that our receiving and distribution process is efficient, unforeseen disruptions in operations due to fires, hurricanes, earthquakes or other catastrophic events, labor shortages and disagreements or shipping problems, may result in delays in the delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members.

We may not timely identify or effectively respond to consumer trends, which could negatively affect our relationship with our members, the demand for our products and services, and our market share.

It is difficult to consistently and successfully predict the products and services our members will demand. Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to timely identify or effectively respond to changing consumer tastes, preferences (including those relating to sustainability of product sources) and spending patterns could negatively affect our relationship with our members, the demand for our products and services and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns and reduce our operating performance. This could have an adverse effect on margins and operating income.

Our failure to maintain positive membership loyalty and brand recognition could adversely affect our financial results.

Damage to our brands or reputation may negatively impact comparable warehouse sales, lower employee morale and productivity, diminish member trust, and reduce member renewal rates and, accordingly, membership fee revenues, resulting in a reduction in shareholder value.

Item 1A Risk Factors (Continued)

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results.

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including, but not limited to, revenue recognition, sales returns reserves, impairment of long-lived assets and warehouse closing costs, inventories, self-insurance, income taxes, unclaimed property laws and litigation, and other contingent liabilities are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance. Provisions for losses related to self-insured risks are generally based upon independent actuarially determined estimates. The assumptions underlying the ultimate costs of existing claim losses can be highly unpredictable, which can affect the liability recorded for such claims. For example, variability in inflation rates of health care costs inherent in these claims can affect the amounts realized. In March 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 were enacted. This legislation expands health care coverage to many uninsured individuals and expands coverage to those already insured. We expect our healthcare costs to increase, but not materially, as a result of this legislation. Similarly, changes in legal trends and interpretations, as well as a change in the nature and method of how claims are settled can impact ultimate costs. Although our estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, any changes could have a considerable effect upon future claim costs and currently recorded liabilities and could materially impact our consolidated financial statements.

Changes in Tax Rates

We compute our income tax provision based on enacted tax rates in the countries in which we operate. As the tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, any change in the enacted tax rates, any adverse outcome in connection with any income tax audits in any jurisdiction, including transfer pricing disputes, or any change in the pronouncements relating to accounting for income taxes may have a material adverse affect on our financial condition, results of operations, or cash flows.

Failure of our internal control over financial reporting could make our financial results inaccurate or untimely.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes: maintaining records that in reasonable detail accurately and fairly reflect our transactions; providing reasonable assurance that transactions are recorded as necessary for preparation of the financial statements; providing reasonable assurance that our receipts and expenditures of our assets are made in accordance with management authorization; and providing reasonable assurance that unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to and cannot provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Any failure to maintain an effective system of internal control over financial reporting could limit our ability to report our financial results accurately and timely or to detect and prevent fraud.

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Item 1A Risk Factors (Continued)

Our international operations subject us to risks associated with the legislative, judicial, accounting, regulatory, political and economic factors specific to the countries or regions in which we operate, which could adversely affect our financial performance.

Our international operations are growing. Future operating results internationally could be negatively affected by a variety of factors, many beyond our control and similar to those we face in the United States. These factors include political conditions, economic conditions, regulatory constraints, currency regulations and exchange rates, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade, monetary and fiscal policies both of the United States and of other countries, laws and regulations of foreign governments and the United States (such as the Foreign Corrupt Practices Act), agencies and similar organizations, and risks associated with having major facilities located in countries which have been historically less stable than the United States. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences and greater difficulty in enforcing intellectual property rights. Additionally, foreign currency exchange rates and fluctuations may have an impact on our future costs or on future cash flows from our international operations.

Market expectations for our financial performance is high.

We believe that the price of our stock generally reflects high market expectations for our future operating results. Any failure to meet or delay in meeting these expectations, including our comparable warehouse sales growth rates, margins, earnings and earnings per share or new warehouse openings, could cause the market price of our stock to decline, as could changes in our dividend or stock repurchase policies.

We rely extensively on computer systems to process transactions, summarize results and manage our business. Disruptions in both our primary and back-up systems could harm our business.

Although we believe that we have independent, redundant, and primary and secondary computer systems, given the number of individual transactions we have each year, it is important that we maintain uninterrupted operation of our business-critical computer systems. Our computer systems, including our back-up systems, are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, internal or external security breaches, catastrophic events such as fires, earthquakes, tornadoes and hurricanes, and errors by our employees. If our computer systems and our back-up systems are damaged or cease to function properly, we may have to make significant investments to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruption in our computer systems may have a material adverse effect on our business or results of operations. The costs, potential problems, and interruptions associated with implementing technology initiatives could disrupt or reduce the efficiency of our operations in the short term. These initiatives might not provide the anticipated benefits or provide them in a delayed or more costly manner.

Natural disasters or other catastrophic events could unfavorably affect our financial performance.

Natural disasters, such as hurricanes or earthquakes, particularly in California or in Washington state, where our centralized operating systems and administrative personnel are located, could unfavorably affect our operations and financial performance. Such events could result in physical damage to one or more of our properties, the temporary closure of one or more warehouses or depots, the temporary

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Item 1A Risk Factors (Continued)

lack of an adequate work force in a market, the temporary or long-term disruption in the supply of products from some local and overseas suppliers, the temporary disruption in the transport of goods from overseas, delays in the delivery of goods to our depots or warehouses within a country in which we operate and the temporary reduction in the availability of products in our warehouses. Public health issues, such as a potential H1N1 flu pandemic (swine flu), whether occurring in the United States or abroad, could disrupt our operations, disrupt the operations of suppliers or customers, or have an adverse impact on consumer spending and confidence levels. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition, and results of operations. These events could also reduce demand for our products or make it difficult or impossible to receive products from suppliers.

We are subject to a wide variety of federal, state, regional, local and international laws and regulations relating to the use, storage, discharge, and disposal of hazardous materials and hazardous and non-hazardous wastes, and other environmental matters.

Any failure to comply with these laws could result in costs to satisfy environmental compliance, remediation or compensatory requirements, or the imposition of severe penalties or restrictions on operations by governmental agencies or courts that could adversely affect our operations.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and sale operations. Increased government regulations to limit carbon dioxide and other greenhouse gas emissions may result in increased compliance costs and legislation or regulation affecting energy inputs could materially affect our profitability. In addition, climate change could affect our ability to procure needed commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which also could face increased regulation. Climate change may be associated with extreme weather conditions, such as more intense hurricanes, thunderstorms, tornados and snow or ice storms, as well as rising sea levels. Extreme weather conditions increase our costs, and damage resulting from extreme weather may not be fully insured.

We are involved in a number of legal proceedings and audits, and while we cannot predict the outcomes of such proceedings and other contingencies with certainty, some of these outcomes may unfavorably affect our operations or increase our costs.

We are or may become involved in a number of legal proceedings and audits, including grand jury investigations, other government investigations, consumer, employment, tort and other litigation (see discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report). We cannot predict with certainty the outcomes of these legal proceedings and other contingencies, including environmental remediation and other proceedings commenced by governmental authorities. The outcome of some of these legal proceedings and other contingencies could require us to take or refrain from taking actions which could unfavorably affect our operations or could require us to pay substantial amounts of money. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management s attention and resources. Our business requires compliance with a great variety of laws and regulations. Failure to achieve compliance could subject us to lawsuits and other proceedings, and lead to damage awards, fines and penalties.

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Item 1A Risk Factors (Continued)

We are subject to the risks of selling unsafe products.

If our merchandise offerings, including food and prepared food products for human consumption, drugs and childrens products, do not meet or are perceived not to meet applicable safely standards or our members expectations regarding safety, we could experience lost sales, increased costs and be exposed to legal and reputational risk. The sale of these items involves the risk of injury to our members. Such injuries may result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, manufacturing, storage, handling and transportation phases. Our vendors are generally contractually required to comply with applicable product safety laws, and we are dependent on them to ensure that the products we buy comply with all safety standards. While we are subject to governmental inspection and regulations and work to comply in all material respects with applicable laws and regulations, we cannot be sure that consumption of our products will not cause a health-related illness in the future or that we will not be subject to claims, lawsuits, or government investigations relating to such matters, resulting in costly product recalls and other liabilities. Even if a product liability claim is unsuccessful or is not fully pursued, the negative publicity surrounding any assertion that our products caused illness or injury could adversely affect our reputation with existing and potential members and our corporate and brand image and these effects could be long term.

Our success depends on the continued contributions of management and on our ability to attract, train and retain highly qualified employees.

Our success depends to a significant degree on the continued contributions of members of our senior management and other key operations, merchandising and administrative personnel, and the loss of any such person(s) could have a material adverse effect. Other than an annual agreement with our CEO, Mr. Sinegal, we have no employment agreements with our officers. We must attract, train and retain a large and growing number of highly qualified employees, while controlling related labor costs. Our ability to control labor costs is subject to numerous external factors, including prevailing wage rates and healthcare and other insurance costs. We compete with other retail and non-retail businesses for these employees and invest significant resources in training and motivating them. There is no assurance that we will be able to attract or retain highly qualified employees in the future, which could have a material adverse effect on the Company s business, results of operations and financial condition. The Company does not maintain key man insurance.

If we do not maintain the privacy and security of member-related information, we could damage our reputation with members, incur substantial additional costs and become subject to litigation.

We receive, retain, and transmit certain personal information about our members. In addition, our online operations at www.costco.com and www.costco.ca depend upon the secure transmission of confidential information over public networks, including information permitting cashless payments. A compromise of our security systems or those of other business partners that results in our members personal information being obtained by unauthorized persons could adversely affect our reputation with our members and others, as well as our operations, results of operations, financial condition and liquidity, and could result in litigation against us or the imposition of penalties. In addition, a security breach could require that we expend significant additional resources related to the security of information systems and could result in a disruption of our operations, particularly our online sales operations.

Additionally, the use of individually identifiable data by our business and our business associates is regulated at the international, federal and state levels. Privacy and information security laws and regulations change, and compliance with them may result in cost increases due to necessary systems

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Item 1A Risk Factors (Continued)

changes and the development of new administrative processes. If we or those with whom we share information fail to comply with these laws and regulations or experience a data security breach, our reputation could be damaged, possibly resulting in lost future business, and we could be subjected to additional legal risk as a result of non-compliance.

Item 1B Unresolved Staff Comments

None.

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Item 2 Properties

Warehouse Properties

At August 29, 2010, we operated 540 membership warehouses:

NUMBER OF WAREHOUSES

	Own Land and Building	Lease Land and/or Building(1)	Total
United States and Puerto Rico	329	87	416
Canada	70	9	79
United Kingdom	19	3	22
Japan	1	8	9
Korea	3	4	7
Taiwan		6	6
Australia	1		1
Total	423	117	540

(1) 77 of the 117 leases are land-leases only, where Costco owns the building.

The following schedule shows warehouse openings (net of closings) by region for the past five fiscal years and expected warehouse openings (net of closings) through December 31, 2010:

Openings by Fiscal Year	United States	Canada	Other International	Total	Total Warehouses in Operation
2006 and prior	358	68	32	458	458
2007	25	3	2	30	488
2008	15	4	5	24	512
2009	8	2	5	15	527
2010	10	2	1	13	540
2011 (expected through 12/31/10)	9	1		10	550
Total	425	80	45	550	

The 32 warehouses operated by Costco Mexico, under our oversight, at the end of 2010 are not included in the above tables.

At the end of 2010, our warehouses contained approximately 77.3 million square feet of operating floor space: 60.2 million in the United States, 10.8 million in Canada and 6.3 million in other international locations, excluding Mexico.

Our executive offices are located in Issaquah, Washington and occupy approximately 581,000 square feet. We operated eight regional offices in the United States, two regional offices in Canada and five regional offices internationally at the end of 2010, containing approximately 334,000 square feet. Additionally, we operate regional cross-docking facilities (depots) for the consolidation and distribution of most shipments to the warehouses, and various processing, packaging, and other facilities to support ancillary and other businesses. At the end of 2010, we operated 12 depots in the United States, four in Canada and three internationally, excluding Mexico, consisting of approximately 7.6 million square feet.

Item 3 Legal Proceedings

See discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Item 4 Removed and Reserved

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PART II

Item 5 Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the National Market tier of NASDAQ under the symbol COST. On October 1, 2010, we had 8,286 stockholders of record.

The following table shows the quarterly high and low closing sale prices as reported by NASDAQ for each quarter during the last two fiscal years and the quarterly cash dividend declared per share of our common stock during the periods indicated.

	Price Range		Cash Dividends
	High	Low	Declared
2010:			
Fourth Quarter	$ 59.16	$ 53.61	$ 0.205
Third Quarter	61.74	57.31	0.205
Second Quarter	60.89	57.07	0.180
First Quarter	61.12	50.65	0.180
2009:			
Fourth Quarter	51.77	44.54	0.180
Third Quarter	48.91	38.44	0.180
Second Quarter	55.58	42.76	0.160
First Quarter	70.37	44.99	0.160

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining the size of the dividends are our profitability and expected capital needs. Subject to these qualifications, we presently expect to continue to pay dividends on a quarterly basis.

Issuer Purchases of Equity Securities (dollars in millions, except per share data)

The following table sets forth information on our common stock repurchase program activity for the 16-week fourth quarter of fiscal 2010:

Period[(1)]	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs[(2)]	Maximum Dollar Value of Shares that May Yet be Purchased Under the Programs[(2)]
May 10, 2010 June 6, 2010	1,800,000	$ 57.57	1,800,000	$ 1,769
June 7, 2010 July 4, 2010	2,025,000	56.82	2,025,000	$ 1,654
July 5, 2010 August 1, 2010	1,717,700	55.64	1,717,700	$ 1,559
August 2, 2010 August 29, 2010	2,225,000	55.97	2,225,000	$ 1,434
Total fourth quarter	7,767,700	$ 56.49	7,767,700	

(1) Monthly information is presented by reference to our fiscal periods during the fourth quarter of fiscal 2010.

(2) Our stock repurchase program is conducted under authorizations made by our Board of Directors: $1,000 was authorized in November 2007, which expires in November 2010; and $1,000 was authorized in July 2008, which expires in July 2011.

Equity Compensation Plans

Information related to our equity compensation plans is incorporated herein by reference to the Proxy Statement. The Proxy Statement will be filed with the SEC within 120 days of the end of our fiscal year.

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Item 6 Selected Financial Data

The following table sets forth certain information concerning our consolidated financial condition, operating results, and key operating metrics for the dates and periods indicated. This information should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 and our consolidated financial statements included in Item 8.

SELECTED FINANCIAL DATA

(dollars in millions, except per share and warehouse number data)

As of and for the year ended[(1)]	Aug. 29, 2010 (52 weeks)	Aug. 30, 2009 (52 weeks)	Aug. 31, 2008 (52 weeks)	Sept. 2, 2007 (52 weeks)	Sept. 3, 2006 (53 weeks)
RESULTS OF OPERATIONS					
Net sales	$ 76,255	$ 69,889	$ 70,977	$ 63,088	$ 58,963
Merchandise costs	67,995	62,335	63,503	56,450	52,745
Gross Margin	8,260	7,554	7,474	6,638	6,218
Membership fees	1,691	1,533	1,506	1,313	1,188
Operating income	2,077	1,777	1,969	1,609	1,626
Net income attributable to Costco	1,303	1,086	1,283	1,083	1,103
Net income per diluted common share attributable to Costco	2.92	2.47	2.89	2.37	2.30
Dividends per share	$ 0.77	$ 0.68	$ 0.61	$ 0.55	$ 0.49
Increase (decrease) in comparable warehouse sales[(2)]					
United States	4%	(2%)	6%	5%	7%
International	19%	(8%)	15%	9%	11%
Total	7%	(4%)	8%	6%	8%
Increase in International comparable warehouse sales in local currency	8%	7%	6%	5%	7%
BALANCE SHEET DATA					
Net property and equipment	$ 11,314	$ 10,900	$ 10,355	$ 9,520	$ 8,564
Total assets	23,815	21,979	20,682	19,607	17,495
Short-term borrowings	26	16	134	54	41
Current portion of long-term debt		80	6	60	309
Long-term debt, excluding current portion	2,141	2,130	2,206	2,108	215
Costco stockholders equity	$ 10,829	$ 10,024	$ 9,194	$ 8,626	$ 9,147
WAREHOUSE INFORMATION					
Warehouses in Operation[(3)]					
Beginning of year	527	512	488	458	433
Opened[(4)]	14	19	34	30	28
Closed[(4)]	(1)	(4)	(10)		(3)
End of Year	540	527	512	488	458

(1) Certain reclassifications have been made to prior years to conform to the presentation adopted in the current year. See further information in Note 1 of Item 8 of this Report.

(2) Includes net sales at warehouses open greater than one year, including relocated facilities.

(3) Excludes warehouses operated in Mexico through a 50% owned joint venture.

(4) Includes warehouse relocations and the closure in July 2009 of two Costco Home locations.

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data)

OVERVIEW

Our fiscal year ends on the Sunday closest to August 31. References to 2010, 2009, and 2008 relate to the 52-week years ended August 29, 2010, August 30, 2009, and August 31, 2008, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Key items for 2010 included:

- Net sales increased 9.1% from the prior year to $76,255, driven by a 7% increase in comparable sales (sales in warehouses open for at least one year, including relocated warehouses) and sales at the 13 new warehouses (14 opened and one closed due to relocation) in 2010. Net sales were positively impacted by the year-over-year increase in the price of gasoline and by the strengthening of certain foreign currency exchange rates;

- Membership fees increased 10.3% to $1,691; however, excluding the $27 charge recorded in 2009 related to a litigation settlement, membership fees increased 8.4%, due to new membership sign-ups and increased penetration of the higher-fee Executive Membership program;

- Gross margin (net sales less merchandise costs) as a percentage of net sales increased two basis points over the prior year;

- Selling, general and administrative (SG&A) expenses as a percentage of net sales improved 10 basis points over the prior year;

- Net income increased 20% to $1,303, or $2.92 per diluted share, compared to $1,086, or $2.47 per diluted share, in 2009;

- The Board of Directors approved an increase in the quarterly cash dividend from $0.18 to $0.205 per share;

- We repurchased 9,943,000 shares of our common stock, at an average cost of $57.14 per share, totaling approximately $568;

- The Board of Directors appointed W. Craig Jelinek as Costco s President and Chief Operating Officer and elected him a director. Jim Sinegal will continue as Chief Executive Officer; and

- In May 2010, we announced the retirement of Dick DiCerchio, as our Senior Executive Vice President and Chief Operating Officer, effective June 4, 2010.

We believe that the most important driver of increasing our profitability is sales growth, particularly comparable sales growth. Comparable sales growth is achieved through increasing the frequency with which our members shop and the amounts they spend on each visit. Sales comparisons can also be particularly influenced by two factors that are beyond our control, including fluctuations in currency exchange rates (with respect to the consolidation of the results of our international operations) and changes in the cost of gasoline and associated competitive conditions (primarily impacting domestic operations). The higher our comparable sales not associated with currency fluctuations the more we can leverage certain of our selling, general and administrative expenses, reducing them as a percentage of sales and enhancing profitability. Generating comparable sales growth is foremost a question of making available to our members the right merchandise at the right prices, a skill that we believe we have repeatedly demonstrated over the long term. Another substantial factor in sales growth is the health of the economies in which we do business, especially the United States. Adverse economic conditions negatively impacted spending by our customers during 2009 and 2010, and that negative impact may continue. Sales growth and our gross margin are also impacted by our competition, which is vigorous and widespread, including other warehouse clubs, discount, department, drug, variety and

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data) **(Continued)**

specialty stores, and supermarkets, as well as internet retailers. While we cannot control or reliably predict general economic health or changes in competition, we believe that we have been successful historically in adapting our business to these changes, such as through adjustments to our pricing and to our merchandise mix, including increasing the penetration of our private label items. Our philosophy is not to focus in the short term on maximizing prices that our members can be charged but to maintain what we believe is a perception among our members of our pricing authority consistently providing the most competitive values. This may cause us, for example, to absorb increases in merchandise costs at certain times rather than immediately passing them along to our members, negatively impacting gross margin.

We also achieve sales growth by opening new warehouses and relocating existing warehouses to larger facilities. As our warehouse base grows and available and desirable potential sites become more difficult to secure, square footage growth becomes a comparatively less substantial component of growth, but the negative aspects of such growth (including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouse when openings occur in existing markets) are ameliorated. Our rate of square footage growth is higher in foreign markets, due to the smaller base in those markets, and we expect that to continue.

Our financial performance also depends heavily on our ability to control costs. While we believe that we have achieved successes in this area historically, some significant costs are partially outside our control, most particularly health care expenses. With respect to expenses relating to the compensation of our employees, our philosophy is not to seek to minimize the wages and benefits that they earn. Rather, we believe that achieving our longer-term objectives of reducing turnover and enhancing employee satisfaction requires maintaining compensation levels that are better than the industry average for much of our workforce. This may cause us, for example, to absorb costs that other employers might seek to pass through to their workforces. Because our business is operated on very low margins, modest changes in various items in the income statement, particularly gross margin and selling, general and administrative expenses, can have substantial impacts on net income.

Results of Operations

Net Sales

	2010	2009	2008
Net sales	$ 76,255	$ 69,889	$ 70,977
Net sales increase (decrease)	9.1%	(1.5%)	12.5%
Increase (decrease) in comparable sales	7%	(4%)	8%
Warehouse openings, net	13	15	24

2010 vs. 2009

Net Sales

Net sales increased 9.1% during 2010 compared to 2009. The $6,366 increase was comprised of a $4,871 increase in comparable sales and the remainder primarily from sales at new warehouses opened during 2010 and 2009.

Foreign currencies, particularly in Canada, Korea, and Japan, strengthened against the U.S. dollar, which positively impacted net sales during 2010 by approximately $1,570 (225 basis points). Net sales were also positively impacted by gasoline price inflation during 2010 by approximately $895 (128 basis points), which resulted from a 17% increase in the average sales price per gallon.

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data) **(Continued)**

Our sales results continue to be negatively impacted by general economic conditions, and those conditions may continue to have a significant adverse impact on spending by our members. We believe, however, that due to the nature of our business model, we are better positioned than many retailers to compete in such an environment.

Comparable Sales

Comparable sales increased 7% in 2010 and were positively impacted primarily by an increase in shopping frequency. Strengthening foreign currencies positively impacted comparable sales by approximately $1,510 (217 basis points) in 2010. Gasoline price inflation positively impacted comparable sales results by approximately $882 (126 basis points) during 2010. Reported comparable sales growth includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

2009 vs. 2008

Net Sales

Our 2009 sales results, particularly in hardlines and softlines, were negatively impacted by general economic conditions. Net sales decreased 1.5% during 2009 compared to 2008. The $1,088 decrease was comprised of a $2,590 decrease in comparable sales, partially offset by an increase of $1,502 primarily from sales at new warehouses opened during 2009 and 2008. Our sales were also impacted by a lower number of warehouse openings year-over-year.

Foreign currencies, particularly in Canada, the United Kingdom, and Korea, weakened against the U.S. dollar, which negatively impacted net sales during 2009 by approximately $2,421 (341 basis points). Net sales were also negatively impacted by gasoline price deflation during 2009 by approximately $2,164 (305 basis points), which resulted from a 30% decline in the average sales price per gallon.

Comparable Sales

Comparable sales decreased 4% in 2009. Weakening foreign currencies negatively impacted comparable sales by approximately $2,339 (333 basis points) in 2009. Gasoline price deflation negatively impacted comparable sales results by approximately $2,113 (298 basis points) during 2009. Comparable sales were negatively impacted by a decline in the average amount spent (after adjustment for gasoline price deflation and measured in local currencies), partially offset by an increase in shopping frequency. Reported comparable sales growth includes the negative impact of cannibalization.

Membership Fees

	2010	2009	2008
Membership fees	$ 1,691	$ 1,533	$ 1,506
Membership fees increase	10.3%	1.8%	14.7%
Membership fees as a percent of net sales	2.22%	2.19%	2.12%
Total cardholders (000 s)	58,000	56,000	53,500

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data) **(Continued)**

2010 vs. 2009

Membership fees increased 10.3% in 2010 compared to 2009. Membership fees in 2010 were positively impacted due to the increased penetration of our higher-fee Executive Membership program, the continued benefit of membership sign-ups at warehouses opened in 2009 and 2008, a 2009 $27 charge to membership fees related to a litigation settlement concerning our membership renewal policy, and the additional membership sign-ups at the 13 new warehouses opened in 2010 (14 opened and one closed due to a relocation). Our member renewal rate, currently at 88% in the U.S. and Canada, is consistent with recent years.

Foreign currencies, particularly in Canada, Korea, and Japan, strengthened against the U.S. dollar in 2010, which positively impacted membership fees by approximately $36.

2009 vs. 2008

Membership fees increased 1.8% in 2009 compared to 2008. The increase was primarily due to membership sign-ups at the 15 new warehouses opened in 2009 (19 opened, two closed due to relocations, and two closed Costco Home locations), the continued benefit of membership sign-ups at warehouses opened in 2008, and increased penetration of our higher-fee Executive Membership program. This increase was negatively impacted by the $27 charge for the litigation settlement discussed above, the weakening of foreign currencies against the U.S. dollar, particularly in Canada, the United Kingdom, and Korea, which negatively impacted membership fees during 2009 by approximately $50, and a lower number of warehouse openings year-over-year. Our member renewal rate at the end of 2009 was 87% in the U.S. and Canada.

Gross Margin

	2010	2009	2008
Gross margin	$ 8,260	$ 7,554	$ 7,474
Gross margin increase	9.4%	1.1%	12.6%
Gross margin as a percent of net sales	10.83%	10.81%	10.53%

2010 vs. 2009

Gross margin, as a percent of net sales, increased two basis points compared to 2009. The core merchandise gross margin, when expressed as a percent of core merchandise sales and not total net sales, increased 25 basis points year-over-year, with all categories showing increases. However, the increased sales penetration of the lower margin gasoline business caused this increase to be only six basis points when expressed as a percent of total net sales. Warehouse ancillary businesses gross margins increased by three basis points as a percent of total net sales. In addition, gross margin comparisons were negatively impacted by five basis points due to a favorable LIFO adjustment in 2009 compared to no adjustment in 2010. Increased penetration of the Executive Membership two-percent reward program and increased spending by Executive Members negatively affected gross margin by two basis points.

Foreign currencies, particularly in Canada, Korea, and Japan, strengthened against the U.S. dollar, which positively impacted gross margin for 2010 by approximately $183.

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data) **(Continued)**

2009 vs. 2008

Gross margin, as a percent of net sales, increased 28 basis points compared to 2008. This increase was primarily related to a net 18 basis point increase in our core merchandise departments, primarily in food and sundries, partially offset by a decrease in softlines, and a net seven basis point increase from our warehouse ancillary businesses, primarily our gasoline and pharmacy departments. The majority of this gross margin improvement was due to our lower margin gas business having lower sales penetration, resulting from the decline in the average selling price per gallon. Increased sales penetration of the Executive Membership two-percent reward program negatively affected gross margin by six basis points. In addition, gross margin was favorably impacted by nine basis points due to reversing the $32 LIFO reserve established in the prior year as we experienced net deflation, year-over-year, in the cost of our merchandise inventories.

Foreign currencies, particularly in Canada, the United Kingdom, and Korea, weakened against the U.S. dollar, which negatively impacted gross margin in 2009 by approximately $258.

Selling, General and Administrative Expenses

	2010	2009	2008
Selling, general and administrative expenses	$ 7,840	$ 7,252	$ 6,954
SG&A as a percent of net sales	10.28%	10.38%	9.80%

2010 vs. 2009

SG&A expenses, as a percent of net sales, improved ten basis points compared to 2009. If the effect of gasoline price inflation on net sales in 2010 is excluded, these expenses increased three basis points compared to 2009. Warehouse operating costs, excluding the effect of gasoline price inflation, increased seven basis points, primarily due to higher employee benefit costs, particularly employee healthcare and workers compensation. SG&A expense comparisons were positively impacted by six basis points related to: the recovery of amounts expensed in fiscal 2007 and 2008 on behalf of certain employees in Canada to cover adverse tax consequences resulting from our previously announced stock option investigation; and a charge recorded in 2009 to write down the net realizable value of the cash surrender value of employee life insurance contracts with no comparable charge this year.

Foreign currencies, particularly in Canada, Korea, and Japan, strengthened against the U.S. dollar, which negatively impacted SG&A for 2010 by approximately $140.

2009 vs. 2008

SG&A expenses, as a percent of net sales, increased 58 basis points compared to 2008. Increased warehouse operating and central administrative costs, as a percent of net sales, negatively impacted SG&A by approximately 56 basis points, resulting primarily from lower sales levels and higher employee health care costs. Higher stock-based compensation expense had a negative impact of one basis point. In addition, we recorded an adjustment to the net realizable value of the cash surrender value of employee life insurance contracts, which negatively impacted SG&A, as a percent of net sales, by two basis points. The net realizable value of the insurance contracts is largely based on

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (dollars in millions, except per share and warehouse number data) **(Continued)**

changes in investment assets underlying the policies and is subject to conditions generally affecting equity and debt markets. In 2008, we recorded a $16 reserve in connection with a legal settlement, which positively impacted the comparison to current year s SG&A expense, as a percent of net sales, by two basis points.

SG&A expenses, as a percent of net sales, for 2009 were adversely impacted by the decrease in the price of gasoline, as it produced a decline in sales dollars without a comparative reduction in labor or other administrative costs. Foreign currencies, particularly in Canada, the United Kingdom, and Korea, weakened against the U.S. dollar, which positively impacted SG&A for 2009 by approximately $217.

Preopening Expenses

	2010	2009	2008
Preopening expenses	$ 26	$ 41	$ 57
Warehouse openings, including relocations	14	19	34

Preopening expenses include costs incurred for startup operations related to new warehouses and the expansion of operations at existing warehouses. Preopening expenses can vary due to the timing of the warehouse opening relative to our year-end, whether the warehouse is owned or leased, and whether the opening is in an existing, new, or international market. The 2009 preopening expense included costs related to several international warehouses that opened in the fourth quarter of fiscal 2009.

Provision for Impaired Assets and Closing Costs, Net

	2010	2009	2008
Warehouse closing expenses	$ 6	$ 9	$ 9
Impairment of long-lived assets	2	8	10
Net gains on the sale of real property			(19)
Provision for impaired assets & closing costs, net	$ 8	$ 17	$

This provision primarily includes costs related to: impairment of long-lived assets; future lease obligations of warehouses that have been closed or relocated to new facilities; accelerated depreciation, based on the shortened useful life through the expected closing date on buildings to be demolished or sold and that are not otherwise impaired; and gains and losses resulting from the sale of real property, largely comprised of former warehouse locations.

2010 vs. 2009

The net provision for impaired assets and closing costs was $8 in 2010, compared to $17 in 2009. The provision in 2010 included charges of $6 for warehouse closing expenses and impairment charges of $2.

2009 vs. 2008

The net provision for impaired assets and closing costs was $17 in 2009, compared to a nominal amount in 2008. The provision in 2009 included charges of $9 for warehouse closing expenses, and impairment charges of $8, primarily related to the closing of our two Costco Home locations in July 2009. The impairment charge in 2008 primarily related to a warehouse in Michigan that was demolished and rebuilt.

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At the end of both 2010 and 2009, the reserve for warehouse closing costs was $5, and primarily related to future lease obligations.

Interest Expense

	2010	2009	2008
Interest expense	$ 111	$ 108	$ 103

Interest expense primarily relates to our $900 of 5.3% and $1,100 of 5.5% Senior Notes (2007 Senior Notes) issued in 2007.

Interest Income and Other, Net

	2010	2009	2008
Earnings of affiliates and other, net	$ 65	$ 31	$ 49
Interest income	23	27	96
Interest Income and other, net	$ 88	$ 58	$ 145

2010 vs. 2009

The decrease in interest income is due to lower interest rates on our cash and cash equivalents and short-term investment balances. Interest income also includes a $12 other-than-temporary impairment loss recognized on certain securities within our investment portfolio in 2009. No impairment was recognized in 2010.

The increase in earnings of affiliates and other is primarily due to an increase in earnings from our 50% owned joint-venture in Mexico. Costco Mexico s earnings increased due to stronger sales and the Mexican peso strengthening against the U.S. dollar. The net gain on foreign currency transactions was $13 in 2010, but was not significant in 2009. These amounts generally relate to the difference between the foreign exchange rate in effect when title to merchandise inventory is transferred and the rate at the time of payment. In addition, there was a favorable $1 mark-to-market adjustment in 2010 compared to a negative $5 adjustment in 2009, related to our forward foreign exchange contracts. See Derivatives section for more information.

2009 vs. 2008

The decrease in interest income was largely due to lower interest rates on our cash and cash equivalents and short-term investment balances resulting from a change in policy to invest primarily in U.S. government and agency securities, which earn lower interest rates. In addition, we recognized $12 of other-than-temporary impairment losses on certain securities within our investment portfolio in 2009 compared to an impairment loss of $5 in 2008. The decrease in the earnings of affiliates was primarily attributable to lower earnings by our investment in Costco Mexico. Costco Mexico s earnings were lower in 2009, primarily due to the peso weakening against the U.S. dollar. In addition, there was a negative $5 mark-to-market adjustment in 2009 compared to a favorable $6 adjustment in 2008, related to our forward foreign exchange contracts.

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Provision for Income Taxes

	2010	2009	2008
Income tax expense	$ 731	$ 628	$ 716
Effective tax rate	35.6%	36.4%	35.6%

The decline in the effective tax rate from 2009 to 2010 is primarily attributable to a change in the mix of earnings between domestic and international operations. The 2009 effective tax rates also include the unfavorable impact of a write-down on investments that were non-deductible for tax purposes.

The lower tax rate in 2008 was primarily attributable to discrete benefits recognized during the year.

Net Income Attributable to Costco (Net Income)

	2010	2009	2008
Net income	$ 1,303	$ 1,086	$ 1,283
Net income per diluted share	$ 2.92	$ 2.47	$ 2.89
Shares used to calculate diluted net income per diluted share (000 s)	445,970	440,454	444,240
Diluted net income per share increase / (decrease)	18%	(15%)	22%

2010 vs. 2009

Net income for 2010 increased to $1,303, or $2.92 per diluted share, from $1,086, or $2.47 per diluted share, during 2009, representing an 18% increase in diluted net income per share. As previously discussed, foreign currencies, particularly in Canada, Korea and Japan, strengthened against the U.S. dollar, which positively impacted net income for 2010 by approximately $61 after-tax, or $0.14 per diluted share. Various factors, discussed in detail above (including sales, membership fees, gross margin, and selling, general and administrative expenses), contributed to the increase in net income for 2010.

2009 vs. 2008

Net income for 2009 decreased to $1,086, or $2.47 per diluted share, from $1,283, or $2.89 per diluted share, during 2008, representing a 15% decrease in diluted net income per share. As previously discussed, foreign currencies, particularly in Canada, the United Kingdom and Korea, weakened against the U.S. dollar, which negatively impacted net income for 2009 by approximately $83 after-tax, or $0.19 per diluted share. Various factors, discussed in detail above (including sales, membership fees, gross margin, and selling, general and administrative expenses), contributed to the decrease in net income for 2009.

LIQUIDITY AND CAPITAL RESOURCES

The following table itemizes components of our most liquid assets at the end of 2010 and 2009 (dollars in millions, except per share data):

	2010	2009
Cash and cash equivalents	$ 3,214	$ 3,157
Short-term investments	1,535	570

Total	$ 4,749	$ 3,727

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Our primary sources of liquidity are cash flows generated from warehouse operations and cash and cash equivalents and short-term investment balances, which were $4,749 and $3,727 at the end of 2010 and 2009, respectively. Of these balances, approximately $862 and $758 at the end of 2010 and 2009, respectively, represented debit and credit card receivables, primarily related to sales in the week prior to the end of our fiscal year.

Net cash provided by operating activities totaled $2,780 in 2010 compared to $2,092 in 2009. This net increase of $688 was primarily attributable to a $371 decrease in our net investment in merchandise inventories (merchandise inventories less accounts payable), an increase in net income of $224, and a $141 increase from the change in our other current operating assets and liabilities.

Net cash used in investing activities totaled $2,015 in 2010 compared to $1,101 in 2009, an increase of $914. This increase relates primarily to a $1,113 decrease in cash provided by the net investment in short-term investments, partially offset by a $195 decrease in cash used for purchase of property and equipment.

Net cash used in financing activities totaled $719 in 2010 compared to $439 in 2009, an increase of $280. This increase was primarily attributable to a $482 increase in cash used to repurchase common stock, a $78 increase in repayments of long-term debt and a $42 increase in dividends paid. These were partially offset by a $124 increase in the net proceeds from stock-based awards and, a $116 increase in the net proceeds from short-term borrowings.

The effect of exchange rate changes, increased cash by $11 in 2010, compared to a decrease of $14 in 2009. This increase was primarily due to the strengthening of foreign currencies, primarily in Canada, Korea, and Japan during 2010.

Dividends

In April 2010, our Board of Directors increased our quarterly cash dividend from $0.18 to $0.205 per share. Our quarterly cash dividends paid in 2010 totaled $0.77 per share, as compared to $0.68 per share in 2009.

Contractual Obligations

Our commitments at year-end to make future payments under contractual obligations were as follows, as of August 29, 2010:

	Payments Due by Fiscal Year				
Contractual obligations	**2011**	**2012 to 2013**	**2014 to 2015**	**2016 and thereafter**	**Total**
Purchase obligations (merchandise)[(1)]	$ 4,492	$ 1	$	$	$ 4,493
Long-term debt[(2)]	111	1,073	126	1,379	2,689
Operating leases[(3)]	162	312	282	1,572	2,328
Purchase obligations (property, equipment, services and other)[(4)]	246	63			309
Construction commitments	186				186
Capital lease obligations[(2)]	10	20	22	256	308
Other[(5)]	6	4	2	26	38
Total	$ 5,213	$ 1,473	$ 432	$ 3,233	$ 10,351

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(1) Includes open merchandise purchase orders.

(2) Includes contractual interest payments.

(3) Operating lease obligations exclude amounts commonly referred to as common area maintenance, taxes, and insurance and have been reduced by $173 to reflect sub-lease income.

(4) The amounts exclude certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.

(5) Consists of $26 in asset retirement obligations, $9 in deferred compensation obligations and includes $3 of current unrecognized tax benefits relating to uncertain tax positions. The total amount excludes $38 of noncurrent unrecognized tax benefits due to uncertainty regarding the timing of future cash payments.

Expansion Plans

Our primary requirement for capital is the financing of land, buildings, and equipment costs for new and remodeled warehouses. To a lesser extent, capital is also required for initial warehouse operations and working capital. While there can be no assurance that current expectations will be realized and plans are subject to change upon further review, it is our current intention to spend approximately $1,600 during fiscal 2011 for real estate, construction, remodeling, and equipment for warehouses and related operations. These expenditures are expected to be financed with a combination of cash provided from operations and existing cash and cash equivalents and short-term investments.

We plan to open up to 31 new warehouses in 2011, including one to two relocations of existing warehouses to larger and better-located facilities.

Additional Equity Investments in Subsidiaries and Joint Ventures

Our investments in the Costco Mexico joint venture and in other unconsolidated joint ventures that are less than majority owned are accounted for under the equity method. We did not make any capital contributions to Costco Mexico (a 50%-owned joint venture) in 2010, 2009, or 2008.

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Bank Credit Facilities and Commercial Paper Programs

				Credit Line Usage at August 29, 2010				
Entity	**Credit Facility Description**	**Expiration Date**	**Total of all Credit Facilities**	**Stand-by Letter of Credit (LC) & Letter of Guaranty**	**Commercial LC**	**Short-Term Borrowing**	**Available Credit**	**Applicable Interest Rate**
U.S.	Uncommitted Standby LC	N/A	$ 22	$ 22	$	$	$	N/A
U.S.	Uncommitted Commercial LC	N/A	50		9		41	N/A
Australia(1)	Guarantee Line	N/A	9				9	N/A
Canada(1)(3)	Multi-Purpose Line	N/A	28	16			12	2.25%
Japan(1)	Revolving Credit	March-11	41			13	28	0.61%
Japan(1)	Bank Guaranty	March-11	18	18				N/A
Japan(1)	Revolving Credit	February-11	41			13	28	0.61%
Japan(2)	Commercial LC	N/A	1				1	N/A
Korea(1)	Multi-Purpose Line	March-11	10	2			8	3.63%
Taiwan	Multi-Purpose Line	January-11	22	5			17	2.63%
Taiwan	Multi-Purpose Line	July-11	16	3			13	2.65%
United Kingdom	Uncommitted Money Market Line	N/A	31				31	3.05%
United Kingdom	Uncommitted Overdraft Line	N/A	46				46	1.50%
United Kingdom(2)	Letter of Guarantee	N/A	3	3				N/A
United Kingdom	Commercial LC	N/A	3	1			2	N/A
		TOTAL	$ 341	$ 70	$ 9	$ 26	$ 236	

(1) The U.S. parent company, Costco Wholesale Corporation, guarantees this entity s credit facility.

(2) Obligations under this facility are fully cash-collateralized by the subsidiary.

(3) The bank may cancel or restrict availability under this facility with 45-days written notice.

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				Credit Line Usage at August 30, 2009				
Entity	**Credit Facility Description**	**Expiration Date**	**Total of all Credit Facilities**	**Stand-by LC & Letter of Guaranty**	**Commercial LC**	**Short-Term Borrowing**	**Available Credit**	**Applicable Interest Rate**
U.S.	Uncommitted Stand By LC	N/A	$ 22	$ 22	$	$	$	N/A
U.S.	Uncommitted Commercial LC	N/A	50		20		30	N/A
Australia[1]	Guarantee Line	N/A	8				8	N/A
Canada[1]	Multi-Purpose Line	March-10	28	18			10	1.76